Coal not yet confined to the "old days" by World Bank Group

At Issue

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BRETTON WOODS project

December 2023

Amid ongoing debates around the World Bank's need to align its operations with the Paris Agreement, the Bank committed to stop funding coal mining and power generation, while its private lending arm, the International Finance Corporation (IFC), will stop its financial intermediary clients funding new coal power projects. However, remaining loopholes mean that even these changes won't prevent the World Bank Group from bankrolling new coal for good.

During a speech at the recent World Bank and IMF Annual Meetings in Marrakech, Morocco, World Bank President Ajay Banga discussed the Bank's support for energy infrastructure in developing countries, including "God forbid, coal, in the old days." Yet, while the Bank imposed a moratorium on direct funding for coal projects in 2013 (see *Bulletin* December 2013), it has failed to ensure that its financial intermediary clients stop funding new coal. This coal funding not only contributes to significant greenhouse gas emissions, exacerbating already disastrous levels of global warming, but also has significant deleterious impacts on the lives and livelihoods of communities in the immediate vicinity of coal projects, as seen with the huge new Java 9 and 10 coal power plants in Indonesia (see *Observer* Summer 2021).

The World Bank continues to fund coal despite an emerging consensus that this is incompatible with limiting global warming to 1.5ºC. Recent years have seen a series of global commitments to cut down on coal made at COP26, by governments in China, India and Indonesia, and by over 200 public and private financial institutions globally. Other Multilateral Development Banks (MDBs), including the European Investment Bank, Asian Development Bank and Asian Infrastructure Investment Bank (AIIB), all rule out support for coal power.

What are the IFC's financial intermediary investments?

Financial intermediary (FI) lending is a specific type of investment by development finance institutions (DFIs) in a financial institution, commonly a commercial bank or private fund. The FI then lends or invests on behalf of the DFI to companies, other financial institutions, or consumers in a specific country or region where the DFI aims to make an impact. DFIs often argue that FI lending allows them to achieve a broader reach and impact compared to direct investments in companies alone. Indeed, FI lending has become increasingly popular with DFIs since the 2008 financial crisis, representing

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just over half of the portfolio of the International Financial Corporation (IFC), the World Bank's private investment arm, and around a quarter of the AIIB's investments.

However, critics argue that FI lending is an 'outsourced' form of development that delegates decisions to private sector financiers, more motivated by, and knowledgeable about, turning a profit than supporting sustainable development. Often, DFI funds may pass through more than one intermediary before eventually supporting a specific 'subproject' (e.g. a power plant or a private hospital). Not only is this bad for transparency (subprojects supported by FI investments are in most cases not disclosed on DFI websites and, crucially, to communities), but it also dilutes environmental and social protections as the investment chain gets longer. Furthermore, this type of lending can act as a roadblock to accountability, as communities adversely affected by FI-backed projects rarely know they have the right to file a complaint for redress to the DFI's accountability mechanism, as they are unaware of its links with the projects.

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FI lending therefore poses several challenges to MDBs' efforts to align with the Paris Agreement. While DFIs suggest FIs are essential for developing markets and for creating the type of finance-based solutions for funding renewable energy that are central to the so-called "Wall Street Consensus" (described by Professor Daniela Gabor as an "effort to reorganise development interventions around selling development finance to the market"), FI investments are by their very nature more opaque and less accountable to the communities they impact. DFIs need to implement strong environmental and social safeguards, with clear exclusions for fossil fuels and other harmful projects, to shift FIs onto a more sustainable investment path that does not violate human rights norms and laws. However, ensuring that such policies are enforced throughout the investment chain is another challenge, requiring a level of detailed supervision that DFIs lack the capacity to implement.

Commitments to shift public finance out of fossil fuels undermined by loopholes

Reforming how DFIs approach FI lending, and raising standards across the board, has therefore become a crucial consideration as DFIs seek to reduce the climate risk in their portfolios. As civil society has documented in detail, the World Bank and other MDBs have come under increased pressure in recent years to stop financing fossil fuel projects (see *Observer* Winter 2021). While the Bank committed to stop financing new coal projects from July 2013 onward - in most circumstances - subsequent developments such as the Paris Agreement in 2015 and repeated reports by the United Nations Framework Convention on Climate Change and the International Energy Agency calling for a rapid phase out of fossil fuels have pushed public finance institutions to go further.

At COP26 in Glasgow in 2021, 39 national governments and public finance institutions committed to "end new direct public support" for fossil fuels, except in limited circumstances, within a year. The statement applies to government signatories' 'voice and vote' at the World Bank and other MDBs, meaning that shareholders should not circumvent or contravene their national commitments by supporting more fossil fuels at multilateral institutions. While valid concerns have been raised about the wording of this commitment, which does not apply to indirect fossil fuel support, and its implementation, the resulting Clean Energy Transition Partnership further ramped up pressure on the World Bank to implement a similar policy (see *Observer* Winter 2021).

Indeed, some change at the Bank was already underway. As well as the Bank participating in the Joint MDB Working Group on Paris alignment since 2017, the IFC changed its approach to investing through financial intermediaries in 2018 to reduce the IFC's exposure to coal projects (see *Observer* Winter 2018). This was prompted, to a significant extent, by the work of civil society organisations (CSOs), including Recourse, Inclusive Development International and the Philippine Movement for Climate Justice, to document the IFC's exposure to 76 coal power projects via financial intermediaries, which resulted in the filing of a mass complaint to the IFC's independent accountability mechanism, the Compliance Advisor Ombudsman (CAO), regarding the IFC's funding of coal plants in the Philippines via its FI client, Rizal Commercial Banking Corporation (RCBC).

Under pressure, then-CEO Philippe Le Houérou introduced the Green Equity Approach (GEA) in 2018 at the IFC, which encouraged intermediary clients like RCBC to phase coal out of their portfolios by 2030. Despite this, the GEA did not prevent intermediaries from continuing to invest in new coal power projects as long as they reduced their overall exposure to near zero by 2030 - a loophole that would have significant consequences less than a year after the GEA was introduced (see *Observer* Winter 2020).

IFC adding fuel to the coal fire in Suralaya

In September of this year, CSOs in Indonesia, PENA Masyarakat and Trend Asia, alongside international CSOs Recourse and Inclusive Development International, filed a complaint to the CAO regarding IFC's indirect financing of two new coal plants in Indonesia. The complaint alleges that the IFC has funded two massive new coal power plants, known as Java 9 and 10, in the Suralaya coal complex in Banten province via its intermediary client Hana Bank Indonesia. Less than a year after the IFC began piloting the GEA with Hana Bank Indonesia as its first client, Hana Bank provided a $56m loan to the developer of Java 9 and 10, PT Indo Raya Tenaga.

While the climate impacts of two new coal plants of this size, representing 1,000 MW of new coal capacity each, would be disastrous enough on their own, the results are catastrophic when they are combined with the eight existing units in the Suralaya coal complex. A key element of the complaint is that developers failed to take into account the cumulative impacts of Java 9 and 10 alongside the other Suralaya units - the majority of which were funded by the World Bank and Asian Development Bank in previous decades.

The construction phase of Java 9 and 10 is already having significant impacts on local communities and wildlife, and these will get far worse when the plant is fully operational. The development is expected to contribute to worsening air pollution as far away as Jakarta, with nearby communities likely to suffer from increased respiratory infections and diseases. Project documents are unclear as to how toxic waste and coal ash will be safely disposed of. Meanwhile, pollution and coal ash from the existing coal plants have already significantly damaged local fish populations, coral reefs and, by extension, the livelihoods of fisherfolk. Alongside the local impacts, which Greenpeace has estimated could lead to up to 7,000 premature deaths over 30 years, Java 9 and 10 will also contribute to significant greenhouse gas emissions, exacerbating the already severe and unprecedented climate impacts being felt across Indonesia.

Despite the lack of political space in Suralaya, where the project holds national significance, affected communities and local CSOs are fighting back. Trend Asia and PENA Masyarakat continue to highlight the egregious impacts Java 9 and 10 will have on local communities and biodiversity, as well as the completely unnecessary nature of the project (as the complaint details, the Java-Bali grid already has excess capacity). One of the parties that will benefit from this project is the coal miners, as Java 9 and 10 are projected

Suralaya Power Station, Indonesia. Credit: Melvinas Priananda, Trend Asia.

to require an average of 7,360,000 tonnes of coal per year. This will prolong the life of coal and will release significant greenhouse gases. The CAO has determined that the complaint is eligible for investigation and is now assessing how to proceed with the case.

Porous policy and weak implementation leave a series of channels for continued coal financing

One major step forward has already been taken by the IFC. In April of this year, it announced that it would no longer allow its new financial intermediary clients to fund new coal projects. This is a significant step that CSOs have been requesting for years, but particularly since the Java 9 and 10 case exposed the loophole in the GEA. Had such a commitment been made as part of the original GEA, it probably would have prevented Hana Bank Indonesia from funding Java 9 and 10.

However, significant gaps remain that will continue to allow IFC finance to leak to coal. As the original GEA documents state, the IFC does not include captive coal power (coal units that support industrial facilities rather than feeding power into the main grid) within its definition of coal-related projects. Captive coal is currently expanding rapidly in Indonesia, representing two-thirds of Indonesia's coal expansion plans in the coming decade, as units are constructed to power smelters to support the growing transition metals industry (particularly nickel).

Significantly, Hana Bank Indonesia is itself exposed to captive coal, having funded a unit that supports a nickel smelter in the Obi Island industrial park. There is therefore an urgent need for the IFC to remove this loophole for captive coal and prevent its FI clients from funding its expansion.

Both the GEA and the Joint MDB Paris alignment approach also fall down by only applying to long-term project finance. This therefore fails to exclude the coal finance being provided by FI clients in the forms of general corporate finance or underwriting, which accounts for 33 per cent of fossil fuel finance globally.

Clarification is also needed on how the IFC is enforcing the 'no new coal' commitment with its existing clients. The updated GEA from April this year says that existing equity clients will be required to stop funding new coal - but research published in October by Recourse, Trend Asia and Inclusive Development International demonstrated that IFC's existing clients are funding 68 GW of new coal across Southeast Asia - more than Germany and Poland's coal capacity combined.

It is therefore fair to say that reports of the death of coal financing by the World Bank Group are, contrary to Banga's claims, exaggerated. Porous policy and weak implementation are leaving a series of channels for continued coal financing to leak from the IFC.

Addressing this issue must be an urgent priority for the IFC and the wider World Bank Group. For the IFC, the continued financing of coal is an embarrassment while peer institutions, like the AIIB and ADB, have come out with clearer and more robust coal exclusions. These loopholes severely undermine the World Bank's aspirations set out in the Evolution Playbook to become a 'better Bank'. WBG management cannot claim to be focused on supporting positive development outcomes, or to be ready to oversee ever-increasing and accelerating financial flows, if it cannot get its own house in order on coal.

But there is an opportunity here also, not just to prevent further problematic investments but also to contribute to a broader global transition away from coal. The IFC should assume responsibility for the role it plays as a global standard setter. It must escape its status as a laggard on coal by instituting a robust 'no new coal' policy. Only by doing so will the IFC be able to play a positive standard-setting role by demonstrating for other public financial institutions and commercial banks how to shift investments from coal to sustainable renewable energy projects that go beyond 'do no harm' and actually protect and enhance human rights.

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The Bretton Woods Project is an Action-Aid-hosted project, UK registered charity no. 274467, England and Wales charity no. 274467, Scottish charity no. SC045476. This publication is supported by a network of UK NGOs, the C.S. Mott Foundation, the William and Flora Hewlett Foundation, and the Well-spring Philanthropic Fund.

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